STATEMENT OF

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HEARING ON

FREIGHT RAIL COMPETITION

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On behalf of the members of the Association of American Railroads, thank you for the opportunity to appear here today to discuss issues related to freight rail competition. AAR members account for the vast majority of freight rail mileage, employees, and revenue in Canada, Mexico, and the United States.

Overview

Most of us here today would probably agree that the economic prosperity of the United States and our ability to compete effectively in the global marketplace depend on the continued viability and effectiveness of our freight railroads. Today, the more than 570 U.S. freight railroads account for 42 percent of the nation's intercity freight ton-miles — more than any other mode. Over a rail network spanning some 143,000 route miles, U.S. freight railroads connect businesses with each other across the country and with markets overseas. Our freight railroads are a vital link to our economic future.

Some of us here today, though, disagree on what steps should be taken — and avoided — in order to safeguard this vital link and allow it to continue to serve our nation's growing freight transportation needs. I respectfully submit to you that S. 919 and its companion bill in the House (H.R. 2924) — the so-called Railroad Competition Act of 2003 — represents exactly the wrong approach. It re-injects government control over wide areas of freight rail operations. It is based on misunderstandings regarding the extent of the competition railroads face. And most importantly, it dooms freight railroads to a state of perpetual capital starvation. By preventing railroads from earning enough to sustain their systems, this bill would inexorably lead to deteriorating rail infrastructure, declining rail service, fewer rail jobs, and eventually the loss of rail service completely on an increasing number of rail lines. Such an outcome is not what our nation needs or deserves.

It can be avoided, though, by maintaining the successful deregulatory system ushered in by the Staggers Rail Act of 1980. As the World Bank's railways adviser once explained, "Because of a market-based approach involving minimal government intervention, today's U.S. freight railroads add up to a network that, comparing the total cost to shippers and taxpayers, gives the world's most cost-effective rail freight service."[1]

Railroads Since the Staggers Act

Before I explain in detail why S. 919 is so pernicious to railroads and to our nation, it is important to dispel the myth that "…the business model that [railroads] have followed since 1980 … does not seem to have been successful."[2] Consider the following:

- Rail intercity freight market share (measured in ton-miles) has been trending upward over the past 15 years, after decades of steady decline prior to Staggers.
- Prior to Staggers, railroads lacked capital to properly maintain their tracks. More than 47,000 route-miles had to be operated at reduced speeds because of dangerous track conditions, and the amount of deferred maintenance was in the billions of dollars. Since Staggers, Class I railroads alone have been able to spend well over $300 billion on infrastructure and equipment, and rail infrastructure investments per mile of road have risen some 28 percent in inflation-adjusted terms. Today, the Class I freight rail network is in better overall condition than ever before.
- Rail productivity rose 183 percent from 1980 to 2002, compared to 10 percent in a comparable pre-Staggers period.
- Nearly all of these productivity gains have been passed through to rail customers (including proponents of S. 919) in the form of sharply lower rates — down 60 percent in inflation-adjusted terms from 1981 to 2002 — saving shippers, and ultimately all of us, billions of dollars per year.

  Numerous studies have confirmed the sharp drop in rail freight rates. For example, a June 2002 U.S. General Accounting Office (GAO) report analyzed rail rates from

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[1] Louis Thompson, World Bank Railways Adviser. Quoted in the Journal of Commerce, July 29, 1998.

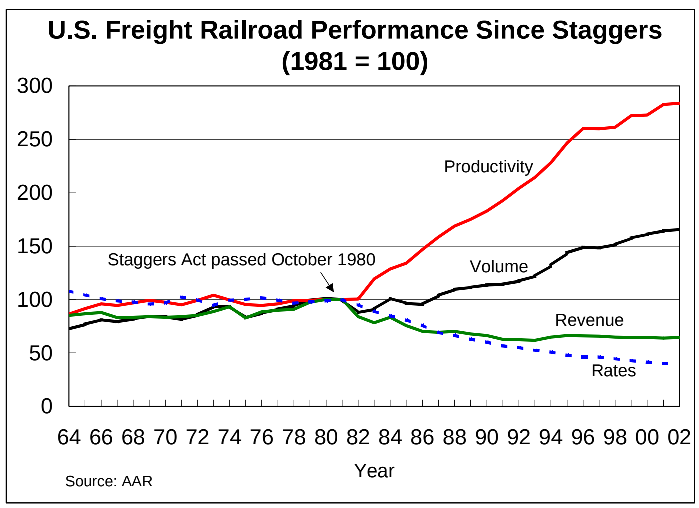
[2] "The Truth About Railroad Claims of Re-Regulation and Their Fear of Competition," prepared by Consumers United For Rail Equity, July 11, 2003.

1997 to 2000. The GAO found that "From 1997 through 2000, rail rates generally decreased, both nationwide and for many of the specific commodities and markets that we examined."[3]

The GAO noted that "[t]hese decreases followed the general trend we previously reported on for the 1990-1996 period and, as before, tended to reflect cost reductions brought about by continuing productivity gains in the railroad industry that have allowed railroads to reduce rates in order to be competitive." In a December 2000 report, the Surface Transportation Board (STB) found that "inflation-adjusted rail rates have fallen 45.3 percent" from 1984 to 1999. The STB also observed, "It is important to note that all types of rail customers, and not just those with competitive transportation alternatives, must have received some portion of the rate reductions we have measured here."[4]

- The rail accident rate has fallen 68 percent since Staggers, and the employee injury rate is down 74 percent. Prior to Staggers, rail safety was generally worsening.
- Rail traffic volume (measured in revenue ton-miles) is up more than 60 percent since Staggers, far higher than comparable pre-Staggers traffic growth.
- By the 1970s, virtually every major railroad in the Northeast, including the giant Penn Central and several major Midwest railroads, had filed for bankruptcy. Most other railroads were financially weak. Since Staggers, railroads have improved their financial performance considerably, though as a whole they still fall well short of earning their cost of capital.

This is not failure by any definition. Thanks largely to the deregulatory structure instituted by the Staggers Act, the U.S. freight rail system today is universally recognized as the best in the world. From a public policy viewpoint, it makes no sense to make fundamental changes to a system that has delivered such large, widespread benefits.



[3] U.S. General Accounting Office, <u>Changes in Freight Railroad Rates from 1997 Through 2002</u>, June 2002.

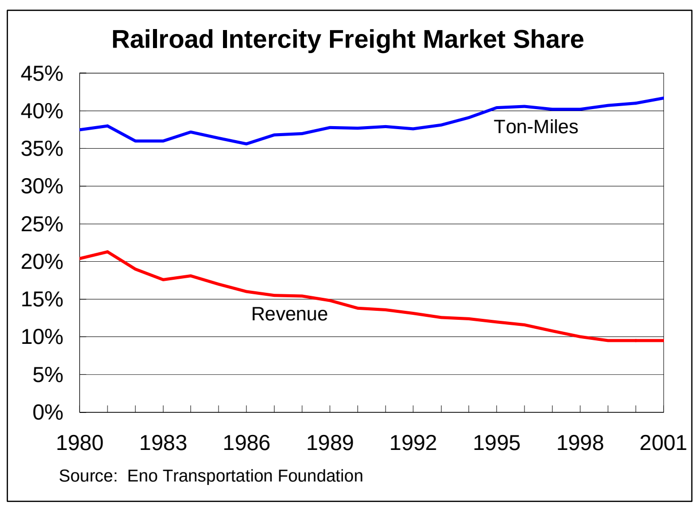
[4] Surface Transportation Board, <u>Rail Rates Continue Multi-Year Decline</u>, December 2000.

Railroad Market Power

Proponents of S. 919 typically maintain that the only competitive force that matters is rail-to-rail competition, and that service to a shipper by a single railroad is equivalent to monopoly power by the railroad over the shipper. This view overlooks the fact that railroads face extensive competition for the vast majority of their business, including cases where a shipper is served by only one railroad.

Railroads compete not just among themselves, but in the larger market for freight transportation services. Most shippers, including most of those served by only one railroad, are able to negotiate competitive rates for rail service. Shippers' considerable market leverage results from a combination of powerful competitive forces. It is unreasonable to pretend that these forces do not matter. These forces include:

- *Intermodal Competition*. Shipment via trucks, barges, or pipelines is a competitive option for most rail customers. Though railroads currently account for 42 percent of total intercity ton-miles, they receive less than 10 percent of intercity freight revenue. The rail revenue share has been trending downward for decades — a trend hardly indicative of excessive market power.

  Railroads face significant competition from other modes even for commodities that some claim are "captive" to railroads. For example, U.S. Department of Agriculture figures indicate that trucks are the primary transportation mode for grain, and the chemical industry's own statistics show that railroads account for less than 20 percent of chemical tonnage that is transported.

- *Product Competition*. Since the demand for rail services is derived from the demand for the products of rail customers, competition faced by rail customers in downstream markets often constrains railroad pricing.

For example, the rates railroads can charge for hauling coal to electric utilities must be low enough to keep the electricity generated from the coal competitive, or utilities will generate (or purchase) electricity from sources other than coal. This end-product competition exerts substantial pressure on railroads to keep prices as low, and service offerings as appealing, as possible.

If a shipper has the option of substituting different products for those that require rail service, then the shipper can use this product competition to constrain rail rates. For example, if railroads attempt to raise soda ash rates too high, manufacturers of phosphate feeds and fertilizers can substitute caustic soda — which can easily move by truck — for the soda ash.

- *Geographic Competition*. The ability of many railroad shippers and consignees to obtain the same product from (or ship the same product to) a different geographic area also constrains rail pricing. For example, a poultry producer in, say, North Carolina can play a railroad delivering feed to it from Ohio off against local feed producers. Likewise, a railroad serving a Louisiana plastics facility must price its transportation service at a level that makes the plastics produced at that facility competitive at destination compared to plastics sourced from different states — or different countries — and transported by other carriers or modes.

  If a railroad that serves a particular facility prices its movements or limits its service offerings in such a way as to render what is produced there uncompetitive with products made elsewhere, the railroad would lose the traffic entirely. Since such an outcome is contrary to the best interests of the railroad, a railroad will do whatever it reasonably can to avoid it.

- *Countervailing Power*. Many railroad customers are large industrial shippers with multiple plants and multiple products, some of which are served by other railroads and/or modes. These shippers can obtain price or service concessions by shifting or threatening to shift traffic among plants, causing the railroads that serve them to compete against each other or the other modes serving the plants.

  For example, significant consolidation among electric utilities in recent years increasingly permits bundling the traffic of many plants into one large "package." A utility with such a package can enhance its leverage for service to all its facilities, including those served by a single carrier. The threat of losing the business is likely to generate price or service concessions by a railroad wanting to keep or win the contract, or to expand its current or future traffic volume. In recent years, consolidation in many other industries such as chemicals, coal, forest products, and steel has improved shippers' bargaining power over railroads.

  It is not unusual for a single customer to account for a large percentage of a particular railroad's revenues, especially within a specific commodity category. This relative importance and threatened loss of railroad revenues substantially increases the likelihood that a particular rail customer will be able to successfully exercise countervailing power in its negotiations with rail carriers.

- *Plant Siting and Long-Term Contracts*. Shippers can generate competition between railroads before a plant is built by considering transportation options and negotiating favorable contracts when evaluating potential plant locations. For example, rail access was an important consideration for Toyota when it recently decided where to locate a new U.S. auto plant. Moreover, over the long term, shippers can locate or relocate plants on the lines of different railroads.
- *Technological, Regulatory, or Structural Change*. Potential changes in the technology, regulation, and/or structure of a shipper's industry over time could provide leverage over railroads. For example, the siting of agricultural processing plants in or near production areas reduces demand for rail transportation and increases pressure on railroads to remain competitive.

Moreover, rail-to-rail competition today is vigorous, with rail customers constantly searching for ways to increase it, using connections to competing carriers (sometimes through a switching carrier) or establishing (or credibly threatening to establish) new connections through "build outs" of rail track.

For example, the Burlington Northern and Santa Fe Railway (BNSF) and a group of chemical shippers are moving forward with plans to build a new 13-mile line which would connect numerous major plastics and chemical-producing facilities in Houston with BNSF's network. The facilities, which ship thousands of rail carloads per year, are now served solely by the Union Pacific Railroad (UP). And according to recent press reports, United Parcel Service (UPS), which may be the single largest customer of the U.S. freight railroad industry, recently reportedly transferred significant traffic that had been moving on BNSF to UP instead. These examples are not anomalies. Rather, they are indicative of the way that railroads compete against each other all over the country.

What Would S. 919 Actually Do?

Railroads do not fear competition, including rail-to-rail competition, as long as it is the product of free-market forces. Unfortunately, S. 919 would artificially manufacture rail-to-rail competition through increased railroad regulation.

Through a variety of provisions, S. 919 would use the power of government to force down rail rates for certain shippers at the expense of other shippers, rail labor, rail stockholders, and the public at large. In doing so, it would transfer billions of dollars per year from the rail industry to favored shippers. If this happened, our nation's freight railroads — who already offer the world's lowest rates and lag most other U.S. industries in terms of profitability — would be doomed to inadequate earnings, unable to make the massive investments required year after year to meet our nation's rail transportation needs. Over time, unless taxpayers stepped in with a bailout, freight service over many rail lines would simply disappear. Highways would become more overcrowded and costly to build and maintain, environmental degradation would rise, safety would deteriorate, and shipping costs would rise. Policymakers should not let this happen.

Proponents of S. 919 object to the railroads' use of "differential pricing." Like businesses throughout the economy, railroads price their services on the basis of demand: shippers with the greatest demand for rail service pay higher margins than shippers with lower demand. At first blush, differential pricing may seem unfair or harsh. In fact, though, it is the fairest, most-pro-efficiency, and most pro-competitive pricing system consistent with the continued functioning of the rail industry. All shippers, *including* those who pay a higher markup, benefit from differential pricing because it maximizes the number of shippers using the rail network and, therefore, maximizes the number of shippers who make contributions to railroads' huge fixed and common costs.

Five major provisions of S. 919 are discussed below. *Each* of them would involve a substantial increase in government regulatory control over the rail industry. Together, they threaten the very existence of freight railroading as we know it in this country. For this reason, S. 919 and all its provisions should be rejected.

A. "Bottleneck" Policy

A central element of S. 919 is a provision that would overturn the STB's "bottleneck" policy. Bottleneck cases are those in which only one railroad (the "bottle-neck" carrier) serves either an origin or a destination, but multiple railroads serve the remaining route. Proponents of S. 919 present the false image that most rail shippers enjoy full two-railroad competition from origin to destination. In truth, a very large proportion of rail shippers are served by just one railroad. Therefore, bottleneck policy has enormous significance for railroads.

Existing bottleneck policy is the result of court decisions going back to the 1920s and regulatory precedent going back even further:

1. As common carriers, railroads must provide rates and routes to move traffic from an origin to an ultimate destination.
2. Railroads cannot refuse to use multiple-railroad routes that are reasonably more efficient than their own single-line routes.
3. Absent a significant disparity in efficiency, however, a railroad does not have to "short haul" itself by moving traffic just to a junction with another railroad if it can move the traffic all the way to the ultimate destination.
4. A railroad is not required to provide a shipper with a separate rate for a segment of a through movement.
5. The rate for a through movement can be challenged for reasonableness under existing maximum rate regulation, and the reasonableness test is based on the cost for the entire through movement.

S. 919 would overturn existing bottleneck policy in every major respect. Upon shipper request, a bottleneck carrier would be required to short-haul itself — *i.e.*, provide a rate for a movement to, and interchange traffic at, any junction with another railroad the shipper so designates. The rate for the short-haul segment would be subject to maximum rate regulation based on the stand-alone cost of just that segment, while the rate of the non-bottleneck segment would be driven down toward variable cost.

By effectively capping rates on segments of a through movement, the new bottleneck policy would ordain that railroads would not be able to cover their full costs or replace their assets over time. The shipper would pay a lower rate, but it is a fallacy to claim, as proponents of S. 919 do, that the rate reduction is the product of more competition. Rather, it is the product of more regulation, and it is not sustainable.

Extended over the entire U.S. rail network, this provision could be expected to lead to a revenue loss to railroads of more than $4 billion per year.[5] No one has convincingly explained how such an enormous revenue shortfall could be recouped, or how, in the face of such a huge revenue loss, the rail industry could continue to make the massive investments required year after year to meet our nation's current and future freight transportation needs. S. 919 dooms the rail industry to a *non-competitive* outcome that is clearly at odds with the needs of our nation.

The bottleneck provision of S. 919 would have other serious negative effects:

- It would lead to an explosion in regulatory proceedings and in costly behavior oriented toward regulatory ends.
- It would compel railroads to splinter traffic over hundreds of interchanges at the direction of shippers, since shippers would be able to dictate to railroads the location of interchanges. This would constitute a return to the "open routing" that characterized the pre-Staggers era and would reverse the substantial progress railroads have made since then in creating a streamlined, efficient nationwide network of run-through trains and efficient blocking.

[5] Based on the 2001 STB Costed Waybill Sample. If in 2001 the rates for all traffic affected by regulation had been held to a revenue-variable cost ratio of 180 percent, the railroads would have received $9.2 billion in revenue instead of $13.4 billion, a revenue loss of $4.2 billion (with no associated reduction in expenses).

B. Terminal Trackage Rights and Reciprocal Switching

Existing law provides that the STB "may require terminal facilities … owned by a rail carrier … to be used by another rail carrier" and "may require rail carriers to enter into reciprocal switching agreements" if the STB finds either measure "to be practicable and in the public interest."

In a series of decisions, the STB — and the Interstate Commerce Commission (ICC) before it — have consistently required that the owning carrier first be found to have engaged in anti-competitive conduct before granting terminal trackage and reciprocal switching rights. This ensures that in STB access cases, like comparable court antitrust cases, relief is predicated on actual competitive conditions and marketplace demand, rather than simply on regulatory intervention on request designed to promote artificial competition. The mere fact that the incumbent is the sole railroad serving a shipper, or that the incumbent chooses not to grant another carrier access, or prices differentially, has never been considered a competitive abuse in this context.

S. 919, though, would upset this structure. It would force the STB, upon request by a shipper, to order railroads to enter into reciprocal switching agreements and provide terminal trackage rights. If, as is likely the case, the railroads involved cannot agree on access terms, government regulators would set them, including the access fee. S. 919 explicitly eliminates the requirement that a railroad must have engaged in anti-competitive conduct before such action could be mandated.

This provision of S. 919 could be interpreted as mandating terminal trackage rights and reciprocal switching whenever it was operationally feasible — thereby essentially creating forced access on demand in terminal areas. As in the bottleneck provision discussed above, the purpose of this provision is to obtain lower-than-market rates by artificially manufacturing rail-to-rail competition in ways beyond what a competitive market could justify.

Meanwhile, regulators would be inundated with unwarranted requests from shippers to grant terminal access. Moreover, regulators would need to step in to resolve myriad disputes covering priorities for use of track, operating conditions, and a host of other issues. Complex, lengthy, and costly disputes over terms of use would be inevitable as government interference replaced direct negotiation among railroads and shippers and between railroads. In addition, the complexities involved in coordination between track owners and operators could have significant safety ramifications.

C. Final Offer Arbitration

Under S. 919, railroad rate and service disputes could be subject (at the shipper's sole discretion — the railroad would have no choice in the matter) to binding "final-offer arbitration" (FOA).

The FOA process would be completely outside the STB's jurisdiction. An arbitrator's decision could be completely divorced from regulatory precedent and sound economic principles — an unacceptable condition in any case, but especially in the rail context in which "final offers" could differ by millions of dollars. Moreover, there would be no requirement that an arbitrator take into account the existing statutory requirement that regulators recognize that "rail carriers shall earn adequate revenues."[6]

[6] 49 U.S.C. 10701 (d)(2)

Railroads know of no other case in which private-sector suppliers of a good or service are forced by the federal government to use binding arbitration to set a price just because the purchaser desires a lower price. It is no more valid for the government to force binding arbitration on railroads than it is to force it on chemical companies, plumbers, supermarkets, or any other business.

This provision too is a frontal assault on railroads' use of differential pricing because it directs arbitrators to base rate decisions in many cases on rates paid by rail customers in the most intensely competitive markets. By definition, these markets have the lowest rates. But a railroad must have a sufficient mix of low-demand, low-margin and high-demand, high-margin shippers to cover its huge common and fixed costs. By using regulatory strictures to eliminate railroads' high-margin traffic and effectively cap rail rates, this provision of S. 919 also dooms railroads to a perpetual inability to cover costs.

Today, railroads and shippers can (and sometimes do) voluntarily agree to use binding arbitration if both parties deem it desirable. There is a huge difference, however, between the voluntary use of binding arbitration and a mandate forced on private businesses by the power of government. In addition, the rail industry has suggested ways to make rate cases quicker and less costly to resolve, while retaining the use of sound, well-established economic principles as a basis for decisions.

D. "Areas of Inadequate Rail Competition"

In a provision of striking scope, S. 919 proposes that the STB designate a state or any part of a state to be an "area of inadequate rail competition" if any of a variety of criteria are met. The criteria used to define these areas are so broad and vague that all or most of the country would qualify — an absurdity on its face, given the intensity of competition railroads face for the vast majority of their traffic. In “areas of inadequate rail competition,” government regulators could assume control of huge areas of rail operations. For example, regulators could:

- Control current and future rail rates;
- Force an owning railroad to allow another railroad access to its tracks where it could “cherry-pick” traffic;
- Force an owning railroad to carry freight to a junction with another carrier at a rate set by a regulator.

Regulators would be expressly prohibited from considering whether railroads engaged in any sort of anti-competitive conduct before ordering these actions.

Railroads are open to ways to improve the existing regulatory regime. However, a return to heavy-handed government regulation — as dramatically exemplified by the concept of “areas of inadequate rail competition” — is anything but an improvement.

E. Interchange Agreements (“Paper Barriers”)

Since passage of the Staggers Act, Class I railroads have spun off tens of thousands of miles to local or regional railroad operators whose lower costs and closer ties to their customers and communities enable them to operate at a profit where Class I railroads could not. These new carriers have preserved rail jobs and rail service — often in rural areas — that otherwise would be lost.

At the time of some line sales, the parties involved voluntarily agreed to a lower sales price in exchange for an agreement by the new railroad to interchange future traffic solely or largely with the selling railroad. In effect, the purchase price included a cash component and a future carload component. S. 919 would prohibit future line sales from including these types of agreements (sometimes called “interchange agreements” or “paper barriers”), thereby prohibiting interested parties from voluntarily using a legitimate tool that has helped preserve rail service on a significant number of rail lines. It would become more difficult for buyers to purchase and keep marginal lines in operation, since their up-front costs would increase. As a result, an increasing portion of the rail network would likely lose rail service entirely through abandonment, rather than have it transferred to short line carriers.

Moreover, S. 919 would allow the STB to declare interchange agreements more than ten years old to be null and void. This would constitute blatant government interference in the sanctity of private contracts — akin to the government deciding that the price someone sold his house for ten years ago was too high and ordering him to rebate some of the sales price to the buyers. It is another example of a provision in S. 919 that proponents would never support if applied to their own firms, but are willing to subject railroads to.

Does S. 919 Reregulate Railroads?

For all the reasons discussed above, it is beyond serious dispute that S. 919 would substantially increase government control over freight rail operations in numerous ways — as good a definition of reregulation as any. The ways that government control would be increased are not just minor intrusions into rail affairs. If enacted, they could be expected to lead to the transfer of billions of dollars of rail revenue each year to favored shippers.

Proponents of S. 919 do not even try to explain how railroads would be able to recoup this revenue, or how railroads could possibly make the huge ongoing investments they need in the face of the capital starvation they would confront. Instead, proponents of S. 919 simply claim "there must be a way"[7] for railroads to remain financially healthy

[7] "Draft Reply to Railroad Letters," June 20, 2003, prepared by supporters of S. 919.

under the legislation. Given how critical freight railroads are, claiming "there must be a way" is not good enough.

A couple of years ago, a prominent Wall Street analyst remarked that "Capital flows to the areas of highest return. If … new regulations change the rules of the game and ensure poor returns, then the Street will disinvest, (or further disinvest) causing managements to begin to reallocate cash and begin "harvesting" the business. They will have no choice."[8]

He was right. In our economy, firms and industries must produce sufficient earnings or capital will not be attracted to them. The electric utility industry understands this. Just a few weeks ago, in the wake of the huge blackout that struck the Northeast, the Midwest, and Canada, the electric industry's major trade association suggested that "FERC and the states should utilize innovative transmission pricing incentives, including higher rates of return, to attract capital to fund needed investments in transmission…[T]he amount of money that FERC [currently] allows investors to earn on transmission facilities still is not in line with what they can earn on other investments."[9] Utilities recognize that "the rate of return that regulators allow for investments in new and augmented transmission facilities must be high enough to be competitive with investors' other options for using their money or sufficient investment funds will not be forthcoming."[10]

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[8] Anthony B. Hatch, independent railroad analyst, in a speech before the American Short Line and Regional Railroad Association, September 14, 1999.

[9] Edison Electric Institute, "Five Steps That Would Help Assure That We Have the Reliability Standards and the Transmission Capacity We Need Going Forward," August 19, 2003.

[10] Stanford L. Levin, "Electricity Competition and the Need for Expanded Transmission Facilities to Benefit Consumers," prepared for the Edison Electric Institute (September 2001), p. 15.

The chemical industry understands this too. For example, one of Dow Chemical's basic financial goals is to "earn an average of 3 percent above our cost of capital."[11] DuPont states that "Our goal continues to be to invest in attractive, globally competitive businesses that generate returns significantly above the cost of capital."[12] BASF, the world's largest chemical company, notes, "We measure our performance and our corporate decision-making against the return required by our investors — our cost of capital. We strive to earn a premium above this cost of capital."[13]

Railroads agree with this sentiment. Without the ability to cover total costs and earn an adequate return, railroads — like electric utilities, chemical companies, or any other firm — would be unable to maintain (much less increase investment in) their infrastructure and equipment, resulting in deterioration and/or shrinkage of the national rail system. That is exactly what S. 919 would do. S. 919 ignores the fundamental point that rail competition is enhanced only when the railroads are healthy, not when their earnings, which are already substandard, are severely and artificially restricted. If S. 919 were enacted, the already large gap between the rail industry's cost of capital and its return on investment would only widen — taking railroads farther away from the financial performance that proponents of S. 919, including some of the firms in the electric utility and chemical sectors, expect from their own businesses.

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[11] "This is Dow Public Report – 2000 Results: Economic Performance," accessed on the Internet at http://www.dow.com/about/pbreports/00results/econ/index.htm.

[12] Quote from Tony Pompeo, DuPont Canada CFO, in "CFO's Address to Shareholders – Annual Meeting 2000," accessed on the Internet at http://www.dupont.ca/english/news/Speeches/2000_annual_cfo_address.html.

[13] "Financial Targets and Management of the BASF Group," part of "Financial Report 2002," accessed on the Internet at http://berichte.basf.de/en/2002/finanzbericht/finanzziele/?id=V00--l33vtG**bir100.

Railroad Customer Service

It is a fact of life in the rail industry that in addition to facing unrelenting competition, the service requirements of rail customers are continually becoming more stringent. Railroads recognize that service shortcomings have been a major factor behind shipper dissatisfaction in recent years, including shipper dissatisfaction that has sometimes manifested itself in calls for railroad reregulation.

I am happy to say, though, that railroads have made tremendous progress in the customer service area. There may be isolated pockets here and there that have some problems (as one would expect on a rail network with enough trackage to circle the globe nearly six times), but overall the U.S. freight rail system today is operating smoothly. Merger-related service disruptions in both the west and the east are now a thing of the past, as the synergies and efficiencies that were the basis for the mergers in the first place are taking hold.

Shippers and others recognize these improvements. Just a few recent examples:

- In an article in the August 18, 2003 issue of Traffic World, UPS spokesman Norman Black says, "The most important thing we see from all of our rail partners is a huge commitment to customer service. They're doing a much better job. Trains are running when they say they're going to run, and arriving when they say they're going to arrive. From a UPS standpoint, that's all we want."
- In a July 25, 2003 article in The Wall Street Journal, Bill Zollars, the CEO of Yellow Corporation, one of the nation's largest trucking companies, says railroads "are more focused on the customer and growing their business than I've ever seen."
- A February 6, 2003 article in Purchasing magazine notes that "[R]ail shippers continue to report consistent efforts and improvements in the level of service they receive from carriers..."
- In a Traffic World article on rail service improvements on January 27, 2003, the rail operations manager at a major U.S. petrochemical company credits railroads with doing "an admirable job of identifying areas of concern and then addressing the problem."
- Canadian National (CN) received on-time service awards from Toyota Canada in 2003 and 2002 and was named the "Canadian Carrier of the Year" for 2002 by

Quaker-Tropicana-Gatorade. In addition, CN's Wisconsin Central subsidiary will be a recipient later this month of a 2003 Quest for Quality Award, having been selected by the readers of Logistics Management as one of the Quality Carriers in the Railroads (Standard Rail Service) category.

- In July 2003, Wal-Mart recognized Burlington Northern and Santa Fe (BNSF) Railway as the recipient of Wal-Mart's annual "Carrier of the Year" award. "BNSF has provided an outstanding service for Wal-Mart," said a Wal-Mart official. "It is our pleasure to recognize their associates for commitment to quality and customer service."
- In April 2003, Toyota Logistics Services recognized Norfolk Southern Railway (NS) with two awards for service excellence during 2002. Toyota awarded NS a "Logistics Excellence Award" for superior quality performance among rail carriers and an on-time performance award for transportation service. NS was also named Coors Brewing Company's 2002 "Transportation Supplier of the Year," the first time NS received the award.
- In June 2003, CSX Transportation was awarded the Gold Carrier Award by Shell Chemicals for the quality of the rail carrier's overall performance in moving Shell chemicals in 2002. The award marks only the third time in the award's 10-year history that a rail carrier was so honored. A Shell official remarked that "CSXT has worked hard at becoming one of the few Gold Carrier recipients. We at Shell would like to give CSXT and its employees a well-deserved congratulation."
- In April 2003, Union Pacific Railroad (UP) was also named a recipient of Toyota's "Logistics Excellence Award." UP also earned a General Motors "Supplier of the Year" Award for 2002. A GM official remarked that UP's "performance and contributions have been critical in helping GM become the industry's low cost producer of high quality vehicles. They serve as a role model for other suppliers."
- In a recent communication, a manager at a Louisiana agribusiness firm wrote: "I have been the complex manager of Terral Farm Service in Delhi, Louisiana for ten years. Over that period of time, we have shipped thousands of rail cars with Kansas City Southern and before that with Mid South. This year, the individuals at KCS performed as well as I could ask for. The service was almost perfect."
- Canadian Pacific Railway's (CP) won the prestigious 2003 Franz Edelman Award for Achievement in Operations Research and the Management Sciences. The award, recognized as the "Tech World Series" and sought after by operations researchers and planners around the world, is presented by the Institute for Operations Research and the Management Sciences. CP won the award for its work on improved scheduling that yields significant, direct benefits to the company's customers.

I firmly believe that the overwhelming majority of railroad customers believe that railroads are meeting their freight transportation needs efficiently, cost-effectively, and fairly. I also believe that most rail customers do not support reregulation, and that many of those who have expressed support for S. 919 would rethink that support if they paused to consider all the implications of the legislation.

We have concrete evidence of the fact that many shippers oppose reregulation. We asked shippers opposed to reregulation to write to members of this committee to express their opposition. Hundreds of shippers, large and small, have done just that. They cover the gamut of rail shippers — auto manufacturers, chemical companies, steel companies, grain companies, coal companies. Some are "singly served" and some are not.

I'd like to share a few excerpts from those letters with you:

- The Alliance of Automobile Manufacturers, a trade association whose members account for more than 90 percent of U.S. vehicle sales, wrote: "Alliance members — as major users of the rail system — view [S. 919] as an attempt to re-regulate the rail industry and undo the progress made since the Staggers Act deregulated it in 1980. We strongly urge the Committee to reject this legislation and maintain the free market system that has been beneficial for shippers and the railroads alike."
- The Port of Los Angeles, one of the largest and busiest ports in the world, wrote, "Increased efficiency and improved service …has enabled the rail industry to divert significant amounts of business from highway to the intermodal option. …None of this would have been possible without the billions of dollars that the railroads have invested in new technology and to improve locomotive and car fleets. To maintain these high standards, railroads will need to continue that level of investment in the future. However, their ability to do so may be negatively impacted by the re-regulation legislation currently being proposed….Our railroads have recovered from the serious financial troubles, including numerous bankruptcies, of the 1970s. We cannot run the risk of that happening again."
- Martco, a Louisiana lumber and forestry firm, wrote, "Senate Bill 919 is an attempt to reregulate the railroad industry. . . Initially the bulk shippers and bulk industries would perhaps benefit by the establishment of some noncompensatory rate structures. The reduced returns would have to be addressed and they would, through the passing of increased rates to the non-bulk and smaller shippers. Thus the pre-Staggers Act cycle would return: reduced rate for shipper A, must be met by increased rates or reduced service for other shippers who then will divert traffic onto our overcrowded highway system…thereby increasing logistics costs to all parties while further reducing the rail industry route structure. Soon rail rates for the few large bulk shippers would have to be increased given the absence of other traffic to spread cost and hopefully provide a return."

- The president of Schneider National — the nation's largest truckload motor carrier — wrote that if S. 919 were passed, "Schneider National and its thousands of shipper-customers would suffer significantly from the loss of a cost effective and efficient intermodal rail system and would be forced to divert much of our volume onto the already crowded highway system. …We believe that additional regulation of the rail system would have a detrimental effect on the progress achieved through a free market."
- The CEO of Kokomo Grain in Indiana wrote to express "strong opposition" to S. 919, writing "[E]ven those shippers that are only served by one railroad and have limited shipping alternatives are better served by a business environment that is not hindered by re-regulation. On the whole, the deregulation of the railroad industry in 1980…has been a positive experience for American business. I do not want to see those gains and benefits thrown aside with a move towards blanket re-regulation to fix certain competitive concerns of some shippers that would be best addressed in other fashions."
- The general manager of the Port of Montana wrote: "S. 919…would significantly reduce railroad revenues by forcing upon them governmentally mandated price "competition" which the free market would not otherwise sustain. …I urge you to continue your support of the current rail regulatory structure. I believe this is the best way our company can guarantee continued access to a healthy railroad network, a network which is critical to our company's competitive success in the domestic and global marketplace."
- Chemical company Dyno Nobel wrote: "Clearly all shippers would like to reduce the rates that they pay for transportation services, but calling for re-regulation of the rail industry is remarkably short sighted and is a move that we do not support. In the long run, all rail users will be the losers because the inevitable result will be to devastate the ability of the railroads to continue providing their present level of service, much less to make vitally needed investments for the future."
- Pavers Supply Company in Conroe, Texas, wrote: "For 33 years we have relied on railroads for transportation of aggregates used in road construction. Railroads will continue to be the most efficient means to deliver the products we need. We strongly urge you to keep our railroad system financially self sufficient and independent of unnecessary government regulation by voting your opposition to S. 919."
- Oregon Steel Mills, one of the most diversified minimills in the United States, wrote: "[D]ue to the influence of the unregulated marketplace, rail service is safer, more reliable, more efficient, and less costly. The situation has been good, not only for the industry itself, but also for customers like Oregon Steel Mills, who use rail service extensively. We urge you to continue your support of the current rail regulatory structure."
- The Port of Beaumont in Texas wrote: "The Port of Beaumont and our customers depend on an economically viable rail network capable of sustaining itself in today's competitive environment. Regulation of the entire rail industry is very

> short-sighted and ill advised at this time. I strongly suggest the Senate reject S. 919 and all other proposals that would re-regulate freight railroads."

The point is this: for every shipper who supports reregulation, there are many others who oppose it. And they oppose it because they rely on rail service and do not want to return to the failed policies of the past.

Conclusion

The partial deregulation of U.S. freight railroads brought about by the Staggers Act has worked. Railroads have been able to upgrade their systems, reinvest hundreds of billions of dollars in productive rail infrastructure and equipment, provide higher levels of service, raise traffic volumes, dramatically increase productivity, improve profitability, and improve safety — while at the same time sharply lowering rates for shippers.

The proposals for rail reregulation in S. 919 threaten all of these gains and are contrary to economic logic and sound policy. They would severely harm rail service, the shippers that rely on that service, and the national economy. They represent the legacy of failure and should be rejected.